TAX INCENTIVES FOR THE PRODUCTION AND USE OF ETHANOL FUELS

Scheduled for a Field Hearing

(Sioux Falls, South Dakota)

Before the

Subcommittee on Oversight

of the

Committee on Ways and Means

on

July 9, 1984

Prepared by the Staff

of the

Joint Committee on Taxation

July 5, 1984

JCX-32-84-A

J862-42
H782-33

INTRODUCTION

The Ways and Means Subcommittee on Oversight has scheduled a field hearing in Sioux Falls, South Dakota on July 9, 1984, to examine tax incentives for the production and use of ethanol fuels.

The first part of this document is a brief summary of the tax incentives provided under present law. This is followed in the second part by a more detailed description of these incentives, including changes made by the Tax Reform Act of 1984.

I. SUMMARY

Present law provides a 5-cents-per-gallon excise tax exemption for alcohol fuels mixtures (e.g., gasohol). A 50-cents-per-gallon income tax credit is provided for the alcohol content in gasohol and for alcohol fuels. A 50-cents-per-gallon import duty is imposed on alcohol imported for use as a fuel.

The Tax Reform Act of 1984, passed by Congress on June 27, 1984, increases the excise tax exemption to 6 cents per gallon; the income tax credit and import duty are increased correspondingly to 60 cents per gallon. These changes are effective on January 1, 1985.

Present law also provides a 9-cents-per-gallon excise tax exemption for alcohol fuels that are at least 85 percent pure if the alcohol is derived from a source other than petroleum or natural gas. The Tax Reform Act expands this provision to allow a 4-1/2-cents-per-gallon excise tax exemption for these alcohol fuels when the alcohol is derived from natural gas. This change is effective on August 1, 1984.

II. DESCRIPTION OF PRESENT TAX INCENTIVES AND PROVISIONS OF THE TAX REFORM ACT OF 1984

A. Present Law

Excise tax exemptions for alcohol fuels mixtures and alcohol fuels

Alcohol fuels mixtures

Present law provides a 5-cents-per-gallon exemption from the excise taxes on gasoline, diesel fuel, and special motor fuels for fuels consisting of mixtures of any of those fuels with at least 10 percent alcohol (Code secs. 4041, 4081, and 6427). The term alcohol is defined to include only alcohol derived from a source other than petroleum, natural gas, or coal. This "gasohol" exemption is computed by treating the alcohol fuels mixture as if it were one of the other taxable fuels. The exemption does not apply to any sale or use after December 31, 1992.

Alcohol fuels

Present law provides a 9-cents-per-gallon exemption from the excise tax on special motor fuels for certain "neat" methanol and ethanol fuels (sec. 4041). The exemption applies to alcohol fuels comprised of at least 85 percent methanol, ethanol, or other alcohol. The exemption does not apply to such alcohol fuels derived from petroleum or natural gas. This exemption expires on October 1, 1988.

Income tax credit for alcohol fuels

Present law allows an income tax credit for alcohol used in certain mixtures of alcohol and gasoline, diesel fuel, or any special motor fuel (e.g., gasohol) if the mixture is sold by the producer for use as a fuel or is so used by the producer (sec. 44E). The credit is equal to 50 cents for each gallon of alcohol used in a qualified mixture. The credit is available only if the sale or use is in a trade or business of the person claiming the credit.

The 50-cents-per-gallon credit also is permitted for alcohol, other than alcohol mixed with another fuel, if the alcohol is used by the taxpayer as a fuel in a trade or business or is sold at retail by the taxpayer and placed in the fuel tank of the purchaser's vehicle.

The amount of any person's allowable alcohol fuels

credit is reduced to take into account any benefit received with respect to the alcohol under the excise tax exemptions for alcohol fuels mixtures or alcohol fuels.

For purposes of the credit, the term alcohol includes methanol and ethanol, but does not include alcohol produced from petroleum, natural gas, or coal.

Duty on imported alcohol fuels

Present law imposes a duty equal to 50 cents per gallon on alcohol imported into the United States for use as a fuel (19 U.S.C. 1202).

B. Provisions of the Tax Reform Act of 1984

The Tax Reform Act of 1984 expands the tax incentives available for the production and use of ethanol fuels, as follows:

Alcohol fuels mixtures.--The Act increases the excise tax exemption for alcohol fuels mixtures to 6 cents per gallon. An additional amendment is made to clarify that alcohol derived from peat is treated as derived from coal in determining availability of this exemption for alcohol fuels mixtures.

Alcohol fuels.--The Act retains the present 9-cents-per-gallon exemption for alcohol fuels at least 85 percent pure if the alcohol is derived from a source other than petroleum or natural gas. The Act also provides a new 4-1/2-cents-per-gallon exemption for such fuels derived from natural gas. Otherwise qualified alcohol fuels that are derived from petroleum will continue to be subject to the full 9-cents-per-gallon excise tax on special motor fuels.

Alcohol fuels credit.--The Act increases the alcohol fuels credit to 60-cents-per-gallon. The Act further clarifies that alcohol produced from peat is deemed to be produced from coal; therefore, such alcohol is not eligible for the credit when used in an alcohol fuels mixture or as an alcohol fuel.

Duty on imported alcohol fuels.--The Act increases to 60-cents-per-gallon the duty on alcohol imported into the United States for use as a fuel.

Effective date.--The changes made by the Tax Reform Act generally are effective on January 1, 1985. The expansion of the excise tax exemption for alcohol fuels at least 85 percent pure is effective on August 1, 1984.